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IN THE

Supreme Court of the United States

October Term, 1954

No. 504

UNITED STATES OF AMERICA, *Petitioner*

v.

ANDERSON, CLAYTON & Co., *Respondent*

On Petition for A Writ of Certiorari to the United States Court of Claims

BRIEF FOR RESPONDENT IN OPPOSITION

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OPINION BELOW

The opinion of the Court of Claims is reported at 122 F. Supp. 837, and reproduced as an Appendix to the Petition.

JURISDICTION

The jurisdictional requisites are adequately stated in the Petition.

QUESTION PRESENTED

The question presented is whether, under Regulation 111, Section 29.22(a)-15, issued under Section 22(a) of the Internal Revenue Code of 1939, the Court of Claims correctly determined "upon examining the real nature of the transaction, considering all the facts and circumstances" that respondent was not dealing in its own shares as it might in the shares of another corporation.

STATUTES AND REGULATIONS INVOLVED

Section 22(a) of the Internal Revenue Code of 1939, and Section 29.22(a)-15 of the Treasury Regulations 111 promulgated thereunder are set forth in the Petition at pages 2-3.

STATEMENT OF FACTS

Those facts found by the Court of Claims and deemed most pertinent by respondent may be summarized as follows:

Anderson, Clayton & Co. was engaged in cotton merchandising in which able, experienced and interested management is of primary importance. (Finding 4, App. 11a[1]) Its capital structure was designed to assure such management. (Findings 3 and 5, App. 11a)

The capital structure was the result of the combined terms of the certificate of incorporation and an agreement between the holders of common stock and the corporation. The certificate of incorporation authorized 300,000 shares, par value $100, participating 4% cumulative first preferred, 75,000 shares, par value $100, participating 4% cumulative second preferred, and 2,856 non-par common. Common stock had no pre-emption rights. (Finding 15, App. 15a). The certificate established a Common Stock

[1]Appendix references are to the Appendix to the Petition.

Surplus to consist of the July 31, 1938, undistributed surplus increased each succeeding year by:

(1) Five Dollars per share on all common stock outstanding; and

(2) Four Per Cent per annum on the common stock surplus balance. Additional surplus constituted "Participating Stock Surplus", one-half belonging to the preferred and one-half to outstanding common. (Finding 16, App. 15a) As of July 31, 1943, the taxpayer had 326,852 shares of preferred stock of a total par value of $32,685,200 outstanding, and 84,083 shares, or $84,083 stated value of common stock outstanding for corporate purposes.[1] (Findings 19, 20 and 21, App. 16a-17a)

The agreement between the corporation and the common stockholders required the trusteeing of the stock, though the stockholder retained the right to vote and receive dividends. Transfers or assignments required written consent of 75 per cent of the stockholders. At death of the holder the corporation was obligated to buy the common stock at its value determined under the contract and the certificate of incorporation, as of the preceding July 31, and the holder's estate was obligated to sell. Similar obligations existed upon withdrawal or dismissal. (Finding 6, App. 12a and 13a)

Transfers were confined to managerial executives, (Finding 9, App. 14a) and made in recognition of increased responsibility and duties. (Finding 5, App. 11a; Finding 8, App. 13a; and Findings 10 and 12, App. 14a)

At M. D. Anderson's death his 18,574 shares of common stock were acquired at the specified contractual value of $50.79 a share and the cost over the $1 stated value was charged to the Surplus Allocated to Common Stock. Prior to the instant transaction 4,035 shares were sold to executives at the lower prevailing values of $32.27 and $33.62,

[1] 18,773 shares of common stock were technically held in the treasury but were not considered outstanding under the certificate or contract. (Finding 25, App. 18a)

the excess over $1 stated value being credited to the common stock surplus. (Finding 22, App. 17a) So long as they were held in the Treasury, shares of common stock were treated as non-existent for all purposes. (Finding 25, App. 18a.; Finding 16, App. 15a; Finding 18, App. 15a and 16a)

During its fiscal year ending July 31, 1944, Anderson, Clayton & Co. allocated and sold 6,500 shares of this stock reacquired from M. D. Anderson to certain managing officials at $112.68 a share in recognition of increased responsibility and duties. (Finding 10, App. 14a) This was the current contractual valuation of each share of the common stock outstanding, as of July 31, 1943, after deduction of an intervening $10 a share dividend. (Findings 21 and 23, App. 17a)

The stated $1 per value of the common stock, which represented its capital under the laws of Delaware, was nominal and the substantial value of such stock was represented by the Common Stock Surplus and the Participating Surplus which amounted to $111.68 per share as of July 31, 1943, after deduction of the $10 dividend declared on November 30, 1943. (Finding 28, App. 18a)

Under the certificate of incorporation, the agreement between the corporation and its common-stock holders and the method of accounting there required and consistently followed, the respective purchases and sales of common stock amounted in substance, in the case of purchases by the corporation, to the withdrawal by the stockholder of earnings accumulated during the period of the ownership of such stock, and in the case of sales by the corporation to new managers to a contribution of capital in an amount equal to accumulated earnings so as to equalize the common equity of all stockholders and the distributions during the ownership of such stock by the executive permitted to buy it. (Finding 27, App. 18a)[1]

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[1] Petitioner omits this substantial finding from its statement of facts relying upon the view that this finding of the

The purchase of the 18,574 shares of the common stock from M. D. Anderson in 1939 was in conformity with the plan that the common stock should be held only by and sold only to active management. The purchase by the corporation was not for the purpose of investment or to deal in its common as it would the stock of another corporation. Under the stockholders agreement with the corporation such common stock could be sold only to persons and upon such terms as might be agreed upon in writing by the holders of 75 per cent of the stock held by the trustee. Such stock could not be issued or transferred by the corporation until the stockholder executed acceptance of the agreement. (Finding 28, App. 18a and 19a)

The sale of 6,500 shares of the common stock to various junior officials in December, 1943, was to adjust the respective holdings in the common stock in accordance with responsibility and to reward managerial performance by the ownership of common stock which would keep cash in the business and compel the executives to acquire the proprietary interest deemed essential, and not for the purpose of dealing in its stock as it would the stock of another corporation. (Finding 29, App. 19a)

REASONS FOR DENYING WRIT

1. The conflict between the decision below and those of various Circuit Courts of Appeal is limited to the question whether "the one factor of failing to actually retire the stock is controlling".

The opinion of the Court of Claims made it clear that it differed with the Circuit Courts' view "considering the one factor of failing to actually retire the stock as controlling". (App. 10a) That was the view urged upon it by petitioner,

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Court of Claims, as well as Findings 28 and 29, constitute conclusions of law (Petition, page 4, footnote 4) Respondent disagrees. With minor language clarifications made by the Court of Claims these are the identical findings of fact reported by the Commissioner, and represent the careful judgment of the Commissioner, and the Court. (See Record, pages 23 and 24) Petitioner filed no exceptions to these findings of the Commissioner.

in spite of the clear and positive provision of the regulations that the question "depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances".

Insofar as every practical aspect of the transaction was concerned the Court of Claims correctly concluded that it was entirely a matter of form whether or not treasury stock or unissued stock was utilized. Retirement of the 18,574 shares representing a stated capital of $18,574 acquired by the corporation at the death of M. D. Anderson required only filing a formal certificate with the State of Delaware. Compared to existing capital of more than $32,000,000 it was truly *de minimis*. Under the Certificate of Incorporation the Directors had full discretion to issue common stock to such persons and for such consideration as they wished. Under the contract between the corporation and the common stockholders the issuance, ownership, and transfer were all closely limited to management. Treasury common was as immobilized for every purpose as unissued common stock. (Finding 25, App. 18a; Finding 16, App. 15a) The corporation had no more and no less freedom in disposing of one than the other. In the case of either, the stated capital of $1 a share represented by any acquisition or disposition was inconsequential.

While some of the purposes involved in the Circuit Court cases cited by petitioner as contrary are similar to those which actuated the capital structure here involved, none of them even remotely accomplished the effect achieved here. The findings of the Commissioner and the Court of Claims in this case distinguish it from any other; and if the regulation is controlling, as *Helvering* v. *Reynolds*, 306 U.S. 110, indicates, the differing decisions are based on the particular facts.

That the Court of Claims regarded its decision as based upon these particular facts is plain from the opposite result it reached in *Edwin L. Wiegand Co.* v. *United States*, 104 C. Cls. 111, 60 F. Supp. 464, which as Judge Littleton,

who wrote both opinions, stated "is distinguishable on the facts". The Court of Claims sustained the regulation in the *Wiegand* case but held that the very different bundle of rights and obligations,—of "facts and circumstances."—resulted in taxable gain. Indeed, the factual situation there was quite comparable to those involved in the decisions of the Circuit Courts which petitioner urges as conflicting. The different result by the same court and judges emphasizes that the only real conflict is one of theory, as to whether the failure to retire the stock involved is controlling, or simply one of the numerous facts and circumstances to be considered.

2. The decision below correctly applies the Regulations to the facts found.

In *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, the Court held that Section 22(a) was so general in its terms as to render an interpretative regulation appropriate and controlling. The earlier regulation involved there and applied by the Court provided expressly that a corporation realized no gain from the sale of its capital stock.

The Court of Claims applied the present regulation to the facts as it determined them; and without openly adopting that position the petitioner is seeking to overturn or disregard the plain terms of its own regulations. If the earlier regulations were appropriate under Section 22(a) and controlling upon petitioner, as the Court held in the *Reynolds* case, then under that decision either the rule of the old regulations is embodied in the statute itself,[1] or the new regulation is appropriate and binding upon petitioner.

The decision of the Court of Claims was based directly upon the regulations. It determined that:

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[1] In the *Reynolds* case, the Court expressly stated it did not need to determine whether the Treasury could change the regulations to its present form without legislative sanction. (Pages 116-117) In the 1954 Code Congress specifically wrote into Section 1032 the terms of the earlier regulation.

"Upon examining the real nature of the transaction, considering all the facts and circumstances, we arrive at the conclusion that plaintiff was not dealing in its own shares as it might in the shares of another corporation." (Appendix 9a to Petition)

Finding 27, (App. 18a) contains its finding of fact as to the real nature of transaction, as follows:

"Under the certificate of incorporation, the agreement between the corporation and its common-stock holders and the method of accounting there required and consistently followed, the respective purchases and sales of common stock amounted in substance, in the case of purchases by the corporation, to the withdrawal by the stockholder of earnings accumulated during the period of the ownership of such stock, and in the case of sales by the corporation to new managers to a contribution of capital in an amount equal to accumulated earnings so as to equalize the common equity of all stockholders and the distributions during the ownership of such stock by the executive permitted to buy it."

That finding was first made by the Commissioner, was not excepted to by the petitioner and was adopted by the Court of Claims with minor language clarifications. It embodies a finding of ultimate fact, which in earlier practice was conclusive, (*Niles Bement Pond* v. *U. S.*, 281 U.S. 357; *United States* v. *Esnault-Pelterie*, 299 U.S. 201) and is obviously not "clearly erroneous" if that be the test now applicable. (*United States* v. *Yellow Cab Co.*, 338 U.S. 338; *United States* v. *U. S. Gypsum Co.*, 333 U.S. 364)

It may also be noted that in an earlier case involving this common stock, *Estate of Monroe D. Anderson* v. *Commissioner*, 8 T.C. 706, 719, the Tax Court stated:

"In other words, the common stock was designed not to be marketable, but to be held in direct proportion to the active participation of each stockholder in the business enterprise."

The substantial effect of the transaction, as well as its purpose, support the judgment of the Court below. The effect achieved, as well as intended, was, for example, to give Harmon Whittington to whom was allocated 2,000 shares an interest in earnings, above stated returns on preferred, equal to [redacted] a share or an additional $10,000 a year and 4 per cent on the amount paid in to the Common Stock Surplus to equalize his position with that of the other 84,083 shares outstanding. (See Finding 27, App. 18a; and Findings 15 to 21, inclusive, App. 15a to 17a) Had he died or withdrawn next day, his interest would have terminated and the corporation would have paid his estate the same amount paid in with one day's interest. (Finding 18, App. 15a) The benefit to the corporation depended upon the usefulness of his services, and that was what the common stock structure was designed to secure.

Respondent did not formally reduce its stated capital when it purchased the 18,574 shares of its non-par common stock from M. D. Anderson. It did not formally increase its stated capital when it issued the 6,500 shares to its newer managing officials. But as the findings show it accomplished substantially that by the use of a nominal $1 value of such stock, and the treatment of Common Stock Surplus as a capital deposit under the provisions of the certificate of incorporation and the stockholders agreement. Respondent had $943,373.46 less capital funds at its disposal after it paid the M. D. Anderson Estate the amount required by the trust agreement; it had $732,420 more when it transferred 6,500 shares to Harmon Whittington and associates in 1943.

Each of these transactions, moreover, had the effect of readjusting the income and priority as to earnings between the preferred and common stockholders.

While the respondent had 84,083 shares of common stock outstanding, the common stockholders were entitled to $420,415 plus 5% on the Common Stock Surplus or a total second priority of $623,352.80 for the year ended July 31,

1943. When the 6,500 shares were issued again to junior management this action of itself increased this preference by $32,500 ($5 x 6500) plus approximately $17,500 interest on the amount paid in to the Common Stock Surplus, or a reshuffling of common stock priority to income in the amount of $50,000 per annum. The novel but express provisions of the certificate of incorporation effected this readjustment. (Finding 16, App. 15a)

Based upon the real nature of the transaction, considering all the facts and circumstances, the Court below could reach no other conclusion than that this was a capital transaction, resulting in no gain to the corporation under the express terms of petitioner's own regulations.

3. This case is not only unimportant for any purpose under the 1954 Internal Revenue Code, but, with its entirely novel facts, is of limited importance otherwise.

Effective January 1, 1954, Section 1032 of the Internal Revenue Code of 1954, expressly provides that:

> "No gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation."

Concerning this section of the Code the House Ways & Means Committee (House Report 1337, 83rd Congress, Second Session, page A268) and the Senate Finance Committee (Report No. 1622, 83rd Congress, Second Session, page 426) state:

> "Under present law, whether the disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends, under certain decisions, upon whether the transaction constitutes the dealing by a corporation in its own shares which is to be ascertained from all of the facts and circumstances. The purpose of this section is to remove the uncertainties of present law."

Congress has thus clearly established as its intended rule, which petitioner admits settles the rules for years after 1953, that no gain or loss is to be recognized from sale by a corporation of its own capital stock.

Clearly, the decision below is unimportant for future years and since it was not decided until July 13, 1954, it obviously could not serve as a pattern for any other transaction.

Petitioner mentions two other pending cases, involving the same general question it poses. *Timken-Detroit Axle Co.* v. *Commissioner*, 21 T.C. 769, pending in the Sixth Circuit, involves the year 1947 and the sum of $68,541.52. That same Circuit decided the very similar case of *Commissioner* v. *Landers Corp.*, 210 F. (2d) 188, in petitioner's favor. The only other case actually cited is *Burrus Mills, Inc.* v. *Commissioner*, 22 T.C. , No. 107, now pending on taxpayer's appeal to the Fifth Circuit. It involves a fiscal year ended May 31, 1947 and the amount of $30,650.

Factually, neither of these cases is comparable to the present case. In *Timken-Detroit Axle Co.* v. *Commissioner*, *supra*, a casual, unconditional sale of treasury stock to an individual whom the company wished to persuade to remain in its employ was involved. *Burrus Mills, Inc.* v. *Commissioner*, *supra*, involved a sale of ordinary common stock under a general employee stock purchase plan.

Neither case involves a special issue of managerial stock, controlled in every respect by a binding agreement between every holder and the corporation, both designed and effective only to give the managerial holder his proper share in the earnings while he was actively participating in management.

Respondent cannot, of course, know the accuracy of petitioner's estimate as to the amount involved in other pending cases, but it can be stated confidently that none of them involves facts, which bring them so plainly within petitioner's regulations, as does the instant case.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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